

Dirk Kempthorne, Governor, State of Idaho

RETIREMENT BOARD



Jody B. Olson Chairman, term expires July 1, 2007



Dennis L. Johnson
term expires July 1, 2005



J. Kirk Sullivan
term expires July 1, 2006



Clifford T. Hayes
term expires July 1, 2009



Pamela I. Ahrens
term expires July 1, 2008

PERSI EXECUTIVE STAFF

Alan H. Winkle, Executive Director
Robert M. Maynard, Chief Investment Officer
John R. Doner, Deputy Director
James E. Monroe, Financial Officer
Judy Aitken, Member Services Manager
Susan Shaw, Benefits Manager
Becky Reeb, Communications Manager
Carol Boylan, Information Technology Manager
Diane Berg, Defined Contribution Manager
Brad Goodsell, Deputy Attorney General

PROFESSIONAL CONSULTANTS

Actuary:	Milliman, Inc., Seattle, WA
Auditor:	Deloitte & Touche LLP, Boise, ID
Medical:	VPA, Inc., Calabasas, CA
Investment:	Callan Associates, Inc., San Francisco, CA CS Capital Management, Inc., Atlanta, GA GMAC Institutional Advisors, San Francisco, CA Hamilton Lane Advisors LLC, Philadelphia, PA R.V. Kuhns & Associates, Portland, OR
Legal:	Calhoun Law Group, Washington, DC Foster, Pepper & Shefelman PLLC, Seattle, WA
Other:	William M. Mercer, Inc., Baltimore, MD Mellon Human Resources & Investor Solutions, Pittsburgh, PA Mellon Transition Management Services, San Francisco, CA
Investment Custodians:	Mellon Global Security Services, Pittsburgh, PA Wells Fargo Bank of Idaho, Boise, ID

Investment Managers:

Apollo Investment Fund, LP, Purchase, NY	McCown DeLeeuw & Co., LP, Menlo Park, CA
Baring America Asset Management Co., Inc., Boston, MA	Mellon Capital Management, San Francisco, CA
Brandes Investment Partners, LP, San Diego, CA	MFS Asset Management, Inc., Boston, MA
Capital Guardian Trust Company, Brea, CA	Mountain Pacific Investment Advisers, Boise, ID
Chisholm Partners, LP, Providence, RI	Nautic Partners, LP, Providence, RI
Clearwater Advisors LLC, Boise, ID	OCM/GFI Power Opportunities Fund, LP, Los Angeles, CA
D.B. Fitzpatrick & Co., Inc., Boise, ID	Pareto Partners, London
Delaware International Advisors, Ltd., London	Providence Equity Partners, LP, Providence, RI
Deutsche Bank, Newark, NJ	Prudential Investments, Newark, NJ
Donald Smith & Co., Inc., New York, NY	Rowe Price International, Inc., London
Frazier Technology Ventures, LP, Seattle, WA	Sanford C. Bernstein & Co. LLC, New York, NY
Furman Selz Investors, LP, New York, NY	Schroder Capital Management International, Ltd., London
Galen Partners, LP, New York, NY	Societe Generale Asset Management Intl, Ltd., London
Genesis Asset Managers, Ltd., London	State Street Global Advisors, Boston, MA
Goense Bounds & Partners A, LP, Lake Forest, IL	T3 Partners, LP, Fort Worth, TX
Gores Capital Partners, LP, Los Angeles, CA	TCW Asset Management Co., Los Angeles, CA
Green Equity Investors, LP, Los Angeles, CA	TCW London International, Ltd., London
Harvest Partners, LP, New York, NY	Thomas H. Lee Equity Fund, LP, Boston, MA
Highway 12 Venture Fund, LP, Boise, ID	TPG Partners, LP, Fort Worth, TX
Ida-West Energy Fund LLC, Boise, ID	Tukman Capital Management, Inc., Larkspur, CA
Koll Partners, Newport Beach, CA	W. Capital Partners, LP, New York, NY
Lend Lease Rosen Real Estate Securities LLC, Berkeley, CA	Zesiger Capital Group LLC, New York, NY
Littlejohn Fund, LP, Greenwich, CT	

More specific information on the above-mentioned investment professionals can be found on pages 50 through 52 in the Investment Section of this report.


Certificate of Achievement for Excellence in Financial Reporting

Presented to

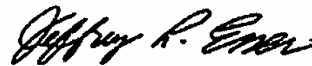
Public Employee Retirement System of Idaho

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2003

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President



Executive Director



Public Pension Coordinating Council
Public Pension Standards

2004 AWARD

Presented to

Public Employee Retirement System of Idaho

In recognition of meeting professional standards for
plan design and administration as
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

Alan H. Winkle
Program Administrator

ORGANIZATIONAL CHART

Retirement Board

Alan H. Winkle Executive Director	John R. Doner Deputy Director	Brad Goodsell Deputy Attorney General	Joanne Ax Management Assistant	
Robert M. Maynard Chief Investment Officer	Richelle Sugiyama Investment Officer	Rose Marie Sawicki Administrative Assistant 1	Investment Managers See Investment Section for a list of managers – page 51	
James E. Monroe Financial Officer	Cecile McMonigle Senior Accountant Rhonda Yadon Senior Accountant Tess Myers Administrative Assistant 1	JoAnne Dieffenbach Financial Technician Sharon Simon Financial Support Technician Alice Brown Office Specialist 1	Debbie Buck Financial Unit Supervisor Jaimie Hiskey Financial Technician Suzanne Jewell Financial Technician	Alan Roberts Financial Technician Pam Whittekiend Financial Technician Barbara Weirick Financial Technician Ken Sholty Financial Technician
Carol Boylan Information Technology Manager	Kris Colt IT Information System Tech Sr. Nancy Fauver IT Database Analyst	Joy Fereday IT Programmer Analyst Sr. Stacy Jones IT Program System Specialist	Ryan Evey IT Programmer Analyst Sr. Stacy Parr Web Developer	Tim Thuis IT Production Specialist Vacant IT Programmer Analyst Sr.
Judy Aitken Member Services Manager	Roger Bartlett Member Services Rep Kari Caven Member Services Rep Lynn Duncan Member Services Rep Lisa Mabe Member Services Rep	Melody Hodges Member Services Rep Susan Strouth Member Services Rep Lisa Conn Member Services Rep	Kathi Kaufman Administrative Assistant 1 Judy Shock Administrative Assistant 1 Lynne Yowell Administrative Assistant 1 Heidi Andrade Office Specialist 2	Vacant Office Specialist 2 Vacant Tech Rec Specialist 2
Susan Shaw Benefits Manager	Catherine Atchison Technical Records Specialist 2 Julisa Adams Technical Records Specialist 2 Penny Walls Technical Records Specialist 2	Margi Bloom Office Specialist 2 Denise Desilet Office Specialist 2 Karen Miller Office Specialist 2 Lenna Strohmeyer Office Specialist 2	Cathy Andrews Technical Records Specialist 1 Kay Prince Technical Records Specialist 1 Gerry Sjol Technical Records Specialist 1 Marian Van Gerpen Technical Records Specialist 1	Shasta Luper Customer Service 1 Vacant Office Specialist 1
Becky Reeb Communications Manager	Bill Duncan Training Specialist	Maxine Thomas Training Specialist		
Diane Berg Defined Contribution Specialist	Betsy Griffith Administrative Assistant 1	Janelle Caitlin Customer Service Rep 2		

THE SYSTEM

The Public Employee Retirement System of Idaho (the System) is the administrator of five pension funds including two defined benefit retirement plans, the Public Employee Retirement Fund Base Plan (PERSI Base Plan) and the Firefighters' Retirement Fund (FRF); and three defined contribution plans, the Public Employee Retirement Fund Choice Plan 401(k) and 414(k) (PERSI Choice Plans) and the Sick Leave Insurance Reserve Fund.

The Retirement Board consists of five members, each appointed by the Governor to fulfill a five-year term. The Board meets monthly to conduct System business, usually on the fourth Tuesday of each month at 8:30 a.m. at PERSI's Boise office.

Administrative expenditures consisting of the personnel costs, operating expenditures, and capital outlay necessary to operate the System are limited to those approved and appropriated by the Legislature for that purpose. In fiscal year 2004 (FY 2004), these costs totaled \$6,991,503 for the defined benefit retirement plans, including \$152,762 in depreciation and \$1,266,272 in amortization expense, which are not cash expenditures and, therefore, not appropriated. The defined contribution retirement plan investment expenses are not included because they are paid by the plan members.

A total of 63 positions comprise the System staff operating from the home office at 607 North 8th Street, Boise, Idaho, and from two member service offices. The Coeur d' Alene office has two staff employees. The Pocatello office has three employees. The Executive Director and investment personnel are exempt positions and are appointed by the Retirement Board to serve at its pleasure. The Deputy Director is in an exempt position serving under the Executive Director. All other staff members serve under statutes and personnel rules governing classified state service.

The System staff oversees the investment of the trust corpus and new contributions with professional investment managers and funding agents. The Retirement Board maintains fiduciary responsibility for investment policy, asset allocation, and the selection of individual investment managers as discussed in the Investment Section.

SUMMARY OF PLAN PROVISIONS

DEFINED BENEFIT "BASE PLAN" PROVISIONS

Note: The items in parentheses are the provisions applicable to members designated as either PERSI firefighters or as PERSI police officer members for retirement purposes.

MEMBER CONTRIBUTION RATE

The employee contribution rate is set by statute at 60% (72%) of the employer rate and as of June 30, 2004, was 5.86% (7.21%).

EMPLOYER CONTRIBUTION RATE

The employer contribution rate set by the Retirement Board was 9.77% (10.01%) as of June 30, 2004.

SERVICE RETIREMENT

ELIGIBILITY

Five years of service and age 65 (60, or between 60 and 65, depending on the ratio of police officer/firefighter service to total credited service).

AMOUNT OF ALLOWANCE

For each year of credited service, the monthly service retirement allowance as of June 30, 2004, was 2% (2.3%) of the monthly average salary of the member's highest 42 consecutive months.

MINIMUM MONTHLY BENEFIT ALLOWANCE

Until February 28, 2004: for each year of service, the monthly minimum benefit allowance was \$20.25 (\$24.30) to a maximum of the member's accrued benefit. Effective March 1, 2004: the monthly minimum benefit allowance was \$20.96 (\$25.15).

NORMAL FORM

Regular retirement allowance for retiree's life only, plus a lump sum death benefit if retiree dies before allowances are paid, total accumulated employee contributions and interest.

OPTIONAL FORMS

Retirees may also choose 50% or 100% contingent annuitant options, as well as Social Security "bridge" options. These are actuarial equivalents of the normal form based on the mortality and interest assumptions adopted by the Board. The allowance is payable for the life of the retiree and designated contingent annuitant.

EARLY RETIREMENT***ELIGIBILITY***

Five years of service and age 55 (50, or between 50 and 55, depending on the ratio of police officer/firefighter service to total credited service).

AMOUNT OF ALLOWANCE

Full accrued service retirement allowance if age plus service, upon separation from employment, total 90 (80, or between 80 and 90, depending on the ratio of police officer/firefighter service to total credited service); otherwise, the accrued service retirement allowance is reduced 3% for each of the first five years by which the early retirement date precedes the date the member would be eligible to receive the unreduced benefit, and by 5.75% for each additional year to a maximum of a second five years. The unreduced benefit entitlement may be either at the service retirement eligibility date or the date eligible for the rule of 90(80).

FORMS

Regular retirement allowance; contingent annuitant allowances for the life of the retiree and a designated contingent annuitant; Social Security level income option for the life of the retiree only or for the life of the retiree and designated survivor.

DISABILITY RETIREMENT***ELIGIBILITY***

Active members must have five years of service and must be disabled from any employment. They are eligible from first day on the job if the disability is due to occupational causes.

AMOUNT OF ALLOWANCE

Projected service retirement allowance based on the highest 42 consecutive month average salary at the time of disability. The benefit is calculated using the accrued service at the time of disability plus the service which would have accrued through service retirement age had the disability not occurred. If a member has less than 360 months of service as of the date he is eligible for disability retirement, he will be given credit for the months of service he would have earned from the date the date of disability to the date he would have reached Service Retirement Age (65 for general members/60 for police and firefighters) had he not become disabled (360 months of credited service maximum). In other words, PERSI will give members up to 30 years of credit or to Service Retirement Age, whichever comes first. Monthly allowance is payable after all temporary compensation ceases and is offset by the amount payable as income benefit under worker's compensation law, except when offset by Social Security.

NORMAL FORM

Regular retirement allowance to normal service retirement age when retirement benefit changes to service retirement allowance with its optional forms available.

DEATH BENEFITS***AFTER RETIREMENT***

Under the normal form of the retirement allowance, a Social Security adjustment option, or a disability retirement, the balance, if any, of the member's accumulated contributions and interest at retirement over all payments received is paid

Introductory Section

to the beneficiary in a lump sum. In the case of a disability retirement, the beneficiary may waive the lump sum if the retiree is married so that the spouse will receive a lifetime monthly allowance, or the beneficiary may take a lump-sum payment of two times the amount in the member's account at the time of disability retirement minus any amount paid. Under the contingent annuitant options, the designated annuitant receives a lifetime monthly benefit following the member's death. If the survivor dies before the balance of the member's accumulated contributions and interest has been paid, the balance will be paid to the beneficiary in a lump sum. If the member's designated contingent annuitant predeceases him/her, the member's allowance will be recalculated to a single life payment.

BEFORE RETIREMENT

- 1 Non-vested Members: Beneficiary receives a lump sum payment of the member's accumulated contributions plus interest.
- 2 Vested Members:
 - a Beneficiary receives a lump sum payment of two times the member's accumulated contributions plus interest.
 - b If the member is married, and the spouse is the sole beneficiary, the spouse may select a lump sum payment or a lifetime monthly benefit.
 - c If the member is married, but the spouse is not the sole beneficiary, the beneficiary may waive the lump sum, in which case, a lifetime monthly benefit is available to the surviving spouse.
- 3 A \$100,000 death benefit for duty-related deaths for police officers/firefighters became effective July 1, 2003.

SEPARATION BENEFIT

Accumulated member contributions with regular interest is payable upon becoming an inactive member separated from eligible employment. The Regular Interest Rate in effect for FY04 was 1.9% per year compounded monthly from July 1, 2003 through December 31, 2003, and 3.22% from January 1, 2004 through June 30, 2004.

POSTRETIREMENT ADJUSTMENTS

An annual postretirement adjustment based on and limited by a cost-of-living factor reflecting the changes in the Consumer Price Index (CPI) is effective March of each year. If the CPI change from August of the previous year to August of the second previous year is 1% or more, a 1% mandatory adjustment is made. The Board may authorize additional discretionary adjustments based on the CPI increase (up to a total maximum annual COLA of 6% or the CPI rate, whichever is lower) if it determines that the System can do so and still maintain an appropriately funded position as required by Idaho Code Section 59-1355(1). Adjustments in excess of the 1% authorized by the Board must be reported to the Legislature. If the Legislature has not acted by the 45th day of the legislative session, the COLA becomes effective March 1 of each year.

The Board is also authorized to award postretirement adjustments for prior years in which the actual amount of adjustment was less than the CPI for those years. If the CPI change is downward, in no event will any benefit be reduced below its initial amount.

The COLA authorized and implemented March 1, 2004, was 2.2 %.



Public Employee Retirement System of Idaho

Governor
Dirk Kempthorne

November 30, 2004

Retirement Board
Jody B. Olson, Chairman
Susan K. Simmons
Dennis L. Johnson
J. Kirk Sullivan
Pamela I. Ahrens

Executive Director
Alan H. Winkle

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Dear Governor Dirk Kempthorne, Legislators and Members of the Retirement System:

We are pleased to present to you the Public Employee Retirement System of Idaho (the System) comprehensive annual financial report, for the fiscal year ended June 30, 2004 (FY 2004). This financial report is a historical perspective of benefits, services, and fiscal activities of the System. Included is a summary of our actuarial valuations, an independent auditor's report, an investment summary, and a statistical section.

Generally accepted accounting principles require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The System's MD&A can be found immediately following the report of the independent auditors.

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to PERSI for its comprehensive annual financial report for the fiscal year ended June 30, 2003. This was the 13th consecutive year that PERSI has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

REPORT STRUCTURE

This FY 2004 comprehensive annual financial report has five sections: the Introductory Section contains this letter of transmittal plus an overview of the fund; the Financial Section contains the independent auditor's report, management's discussion and analysis, the financial statements, and supplementary data; the Investment Section contains the fund's investment performance, strategy, and guidelines; the Actuarial Section contains the consulting actuary's certification letter and a summary of the results of the actuarial valuations and related data; and the Statistical Section contains tables of significant data.

This Letter of Transmittal is intended to serve as an overview of the System and to "transmit" information on the topics below.

PLAN HISTORY

The Public Employment Retirement System of Idaho was created by the Thirty-seventh Legislature, Regular Session of 1963 with funding effective July 1, 1965. It is a tax qualified, defined benefit system to which both the member and the employer contribute. Participation in the System is mandatory for eligible state and school district employees and available to other public employers and their employees on a contractual basis.

When the Teachers Retirement System of Idaho was abolished, members of that system were integrated into PERSI, and

all other eligible school district employees became PERSI members effective July 1, 1967.

Legislative amendments since 1965 have made it possible for municipal police officer retirement funds to merge with the System, and two of the five police officer systems have since merged. The other three are being phased out, and police officers hired since 1969 have become members of the System.

Legislation in 1979 mandated that the Firefighters' Retirement Fund be administered by PERSI effective October 1, 1980. Paid firefighters who were members of the original system, retain their original benefit entitlement, while paid firefighters hired after October 1, 1980, are entitled to PERSI benefits. An actuarial valuation of the firefighter member benefit entitlement is conducted every year, separate from the annual PERSI valuation.

In January 2001, PERSI implemented a "Gain Sharing" program as a way to distribute \$155 million in excess investment earnings back to our active members, retirees and employer members. Retirees received their gain sharing as a "13th Check." Employers received their share as a contribution "holiday." Some 53,000 eligible active members received their portion as deposits into newly created defined contribution (DC) accounts. This new plan, which is in addition to PERSI's traditional Defined Benefit (DB) "Base" Plan, is called the PERSI "Choice" Plan. It allows employees to actively participate in saving for their retirement.

The Choice Plan is very unique to the public sector. PERSI obtained permission from the Internal Revenue Service to expand a grandfathered State 401(k) to our members statewide. While some public employees were familiar with 457 or 403(b) plans, a 401(k) was something quite new to them. Many of our members had never had the opportunity to make such pre-tax voluntary contributions.

SERVICES PROVIDED

The ability of the System to serve both employee and employer members at the local level through the Boise, Pocatello, and Coeur d' Alene offices remains a key factor for efficient administration. The merging of other retirement systems with PERSI, plus statutory amendments over the years, have produced both multiple and diverse member benefit entitlements and administrative requirements. These can best be analyzed and explained to the members through personal contact by knowledgeable System staff members.

In its 39th year of operation, the System continued a wide range of services to the employee and employer members. Members may visit our website, call, e-mail, or stop by one of the three offices for personal information and assistance regarding credited service, account balances, eligibility, benefit options and amounts, and other retirement matters.

Members receive advance notice of service retirement qualification and are provided with estimates of monthly allowances. They also receive information regarding alternate forms of retirement payments available. Retirement applications are processed in a timely fashion, and monthly payments are made promptly. Direct deposit of benefit payments is made available to retired members as is withholding for income tax, medical insurance, or other purposes.

System retirees are provided notices each time their net benefit amount changes. This notice gives the retiree a list of their itemized deductions from their gross benefit.

Separation and death benefits are paid in an orderly manner and as rapidly as possible. In some instances payments are expedited to avoid financial hardship on a member.

Employee contributions and earned interest are posted to individual member accounts each month, and an annual statement is provided to each member confirming their average monthly salary, credited service, contributions, and earned interest. In addition, a report of benefits accrued to date is provided along with an estimate of benefits projected ahead to various retirement ages.

The staff of employer units responsible for reporting and handling retirement transactions and activities has provided training and assistance through monthly bulletins and personal contact by field service personnel on a regular basis and as needed. Employer records and reporting procedures are reviewed each year for accuracy and compliance with statutory provisions.

Upon request, public employers interested in affiliation with the System are counseled and provided with information regarding employee benefits, cost and procedures associated with joining. Conversely, employers considering withdrawal are provided information and employee benefit projections to enable them to make an informed decision.

Pre-Retirement and Financial Planning Workshops are offered around the State covering financial planning, budgeting, investment basics, as well as Social Security and System benefits.

EMPLOYEE AND EMPLOYER MEMBERSHIP

During FY 2003, the number of active PERSI members increased from 62,385 to 63,385. The number of retired members or annuitants receiving monthly allowances increased from 24,991 to 26,043. The number of inactive members who have not been paid a separation benefit increased from 18,599 to 18,837. Of these inactives, 8,118 have achieved vested eligibility. Total membership in PERSI increased from 105,975 to 108,265 during the fiscal year. There are currently 675 public employers in Idaho who are PERSI members. Participating employers are listed in the Statistical Section of this report.

MANAGEMENT RESPONSIBILITY

The System's management is responsible for the complete and fair presentation of the data and the accompanying disclosures in this report. The financial statements and supplemental schedules included in this report have been prepared in accordance with generally accepted accounting principles for governmental accounting and reporting as pronounced or adopted by the Governmental Accounting Standards Board.

INDEPENDENT AUDIT

The System is audited annually, and for the fiscal year ended June 30, 2004, the audit was conducted by Deloitte & Touche LLP, an independent firm of Certified Public Accountants. Refer to the Independent Auditors' Report for the opinion.

INTERNAL ACCOUNTING CONTROL

As an agency of the State of Idaho, the System's administrative expenses are subject to the State's budget controls. Management is responsible for maintaining a system of internal accounting control designed to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization and are recorded as needed to maintain accountability for assets to permit preparation of financial statements. An internal control procedure has been established, and a budget report is prepared for the Board. We believe the internal controls in effect during FY 2004 adequately safeguard the assets and provide reasonable assurance regarding the proper recording of financial transactions.

FINANCIAL HIGHLIGHTS

Collection of employer and employee contributions, as well as income and gains from investments, provides the reserves necessary to finance retirement benefits. These income sources totaled \$1,574,442,377 for all pension funds during the fiscal year ended June 30, 2004.

ADDITIONS:

Contributions	\$ 393,108,117
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INVESTMENT INCOME:

Net Appreciation in Fair Value of Investments	1,001,322,358
Interest, Dividends and Other Investment Income	208,641,123
Less: Investment Expenses	<u>(28,706,915)</u>
Net Investment Income	1,181,256,566

OTHER INCOME

77,694

Total Additions	<u>\$ 1,574,442,377</u>
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The payment of benefits is the primary expense of a retirement system. The payments, together with the expenses to administer the Plan, constitute the total expenses of the System. Expenses for FY 2004 are as follows:

DEDUCTIONS:

Benefits and Refunds	\$ 355,325,180
Administrative Expenses	6,991,503
Transfers Out	<u>1,976,643</u>
Total Deductions	<u>\$ 364,293,326</u>

Contributions and expenses continue to increase at a predictable rate.

AMOUNT SHOWN BELOW AS ACTUARIAL PRESENT VALUE OF FUTURE BENEFITS

Future benefits include all benefits estimated to be payable to plan members (retirees and beneficiaries, terminated employees entitled to benefits but not yet receiving them, and current active members) as a result of their service through the valuation date and their expected future salary. The actuarial present value of future benefits as of the valuation date is the present value of the cost to finance benefits payable in the future, discounted to reflect the expected effects of the time value (present value) of money and the probabilities of payment. Expressed another way, it is the amount that would have to be invested on the valuation date so that the amount invested plus investment earnings will provide sufficient assets to pay total future benefits when due.

The actuarial present value was calculated as part of an actuarial valuation at July 1, 2004. Significant actuarial assumptions used include: an investment return rate of present and future assets of 7.75% compounded annually, (7.25% plus 0.50% for expenses); projected salary increase of 4.50% per year compounded annually, attributable to general wage increases; additional projected salary increases attributable to seniority/merit, up to 7.00% per year, depending on service and employee classification, and; 1.00% per year attributable to postretirement benefit increases.

At June 30, 2004, the unfunded actuarial liability on a current contribution basis was as follows:

Unfunded Actuarial Liability on Current Contribution Basis (in millions):

	Valuation Date:	July 1, 2004
	Benefit Date:	July 1, 2004
A. Actuarial Present Value of All Future Benefits for Contributing Members, Former Contributing Members and Their Survivors		\$ 11,044.2
B. Actuarial Present Value of Total Future Normal Costs for Present Members		2,889.4
C. Actuarial Liability [A - B]		8,154.8
D. ORP Contributions		63.5
E. Actuarial Liability Funded by PERSI Contributions [C-D]		8,091.3
F. Actuarial Value of Assets Available for Benefits		7,420.2*
G. Unfunded Actuarial Liability (funding excess) [E-F]		\$ 671.1
H. Amortization Period on Valuation Date, Based on Contribution Rate Established as of Benefit Date		7.8 Years
I. Funded Ratio [F/E]		91.7%**

- * The total available assets are \$7,648.5 million, but are reduced by \$228.3 million for assets used in plan operations and funds earmarked to provide excess benefits to former members of the Firefighter's Retirement Fund and the Idaho Falls Police Retirement Fund.
- ** The Funded Ratio of 91.7% includes the effects of the 1% mandatory COLA but not the additional discretionary COLA and the retro COLA calculated at 1.7% and .8%, respectively. The discretionary COLA decreases the ratio to 91.1%.

ECONOMIC CONSIDERATIONS

The System operates within a dynamic economic environment, as do all investment funds. The objective of the Retirement Board is to minimize the effect of these external influences, where possible, by diversifying among a broad range of asset classes and investment management styles, both domestically and internationally. Such diversification, combined with prudent management by experienced investment professionals, increases the probability that the earnings objective will be achieved. The return for fiscal year 2004 was 17.51% net of expenses.

The Public Employee Retirement System of Idaho is funded on a sound actuarial basis, which protects future benefits for participants. Over the long-term, the Plan's assets should achieve their expected returns. However, short-term shortfalls in earnings targets could occur in unfavorable economic environments and/or unfavorable actuarial experience. As of June 30, 2004 the fund had an amortization period of 7.8 years.

INVESTMENT STRATEGY AND POLICIES

The Retirement Board utilizes and directs funding agents to provide whatever investment management and custodial functions best achieve the System's investment objectives. The Board establishes asset allocation policy, diversification guidelines, custodial functions including safe-guarding of investments, and other investment restrictions. Each money manager is generally granted full discretion in making investment decisions within their guidelines. The Board, staff, and consultants monitor and evaluate investment results. The Board, in its administration of this System and management of the investment program, is guided by the fiduciary standards in Section 59-1301 of the Idaho Code and the Idaho Uniform Prudent Investor Act, in Sections 68-501 through 68-514 of the Idaho Code and is empowered in its sole discretion to limit, control, and designate the types, kinds, and amounts of investments. Current year investment information and return can be found in the Investment Section of this report.

FUNDING STATUS

The funding objective of PERSI is to accumulate sufficient assets to ensure that funds will be available to meet current and future benefit obligations to participants on a timely basis. If the level of funding is high, the ratio of assets to the actuarial accrued liability is also greater, which means better investment income potential. Each year, an independent actuary engaged by PERSI calculates the amount of the annual contribution that the plans must make in order to fully meet their obligations to retired employees. As of June 30, 2004, the PERSI Base Plan has succeeded in funding 91.7% of the present value of the projected benefits earned by employees. The remaining unfunded amount is being systematically funded over 7.8 years as part of the annual required contribution calculated by the actuary. The closed Firemen's Retirement Fund remains an actuarially-funded plan. For GASB reporting purposes, the Notes to Required Supplemental Schedules on page 38 provides detailed information on each plan's remaining amortization period. The actuarial method for calculating accrued liability for both plans is Entry Age Normal with the objective of maintaining employer contributions approximately level as a percent of member payroll. For a more in-depth discussion of PERSI's funding, see Management's Discussion and Analysis and the Actuarial Section of this report.

MAJOR INITIATIVES

This year, PERSI initiated a major, multi-year Business Process Reengineering (BPR) project that may revolutionize PERSI's customer service delivery. In the first stage of the process PERSI contracted with MAXIMUS, Inc. to document the current state of affairs at PERSI (As Is) with detailed business process maps for each of PERSI's main service and business processes as they exist today. The As Is report, identified inputs, outputs, resources and performance measures for each process. The As Is report served as a baseline for what PERSI strives "To Be" in the future.

In the To Be phase of the project, PERSI and MAXIMUS, Inc. focused on the operational changes that could be implemented to improve overall service delivery to PERSI members and employers in a "blue sky" environment. That is, if all limitations were removed, how would PERSI staff design the organization to give the best service possible to members and employers.

“Building PERSI Right – A Business Process Reengineering Plan for the Future” is the final product in the planning phase of BPR project. This phase, which was approved by the Retirement Board, focuses on the concepts that were developed during staff strategy sessions, analyzes the difference between what “is” and what “is desired,” analyzes the costs and benefits of the desired characteristics, and begins planning for the implementation of those characteristics that make good business and/or service delivery sense. It includes a Gap Analysis and presents a road map for making the To Be model a reality through delivery of the Final Recommendations and Implementation Plans.

As a direct result of the phases above, a new customer service model called “PERSIcare” has been developed that includes:

- **“One Stop” or “Holistic” approach to Customer Service:** One of the comments heard repeatedly in the staff sessions was the need for PERSI to speak with one voice and that each member of PERSI staff should be able to provide members and employers with “consistent answers to standard questions.” Currently PERSI members may be required to speak to two, three or more staff members to get all their questions and/or requests answered. This is frustrating to the member and staff as well as cumbersome to PERSI operations. By taking a “holistic approach” to customer service, PERSI staff will be able to provide the customer with the majority of answers or services requested at one time regardless of the subject and serve members more effectively and evenly without losing the PERSI “personal touch.”
- **Cross-functional organizational environment:** During To Be sessions, many PERSI staff members spoke of offering “cross training” to all PERSI employees to facilitate their ability to achieve the new customer service delivery goals. At this time, some staff members voiced concern that they did not necessarily know enough about other staff members’ job responsibilities and duties; while others stated that in some cases if one staff member is not in the office on a particular day, there are no other PERSI employees who are available to perform his or her duties. Still others voiced the need for cross-training across the organization so that all PERSI staff know how to answer questions and perform processes for members and employers.
- **Customer self-service tools available to all:** Customer self service generally refers to providing methods for customers to use themselves to gather information on or submit requests to an organization without assistance from the organization’s staff. Online banking, ordering of goods or services via the Internet or automated telephone services, the use of kiosks, and related services are all examples of common customer self service methods currently available. At PERSI, staff recommended providing similar services to those members who choose to access such services.

Each of these concepts contribute to building PERSIcare, a new customer service model that fulfills the PERSI mission and continues to promote the PERSI drive to offer exceptional service to members and employers. To move to this customer service model for the future, PERSI will be required to make significant changes to its business processes currently in place for delivering service, organizational structure, training plans, and technology resources. Dramatically improved customer service and the ability to meet the growing needs of the membership will be the result. Improved services will address areas where PERSI lags its peers and increases in productivity will help to address the growing workload triggered by the pending retirement of the baby boomer generation.

ACKNOWLEDGMENTS

This financial report of the Public Employee Retirement System of Idaho was prepared by staff under the leadership of the Retirement Board. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means of determining responsible stewardship for the assets contributed by the members and their employers.

This report is being sent to the Governor, State Legislators, and other interested parties.

Respectfully submitted,

Jody B. Olson, Chairman

Alan H. Winkle, Executive Director

James E. Monroe, Financial Officer